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**# 2(07)**

## ***Budget Process in the Caspian Countries: Experience of Kazakhstan and Azerbaijan***

*Since 2000 Kazakhstani and Azerbaijani economies were demonstrating high growth rates due to escalating hydrocarbon production and high prices on them in the world markets.*

*The revenues from natural resources should be spent on improving living standards and poverty reduction, which would lead to sustainable economic growth. This will become possible if budget provides complete information on the channels of revenue and expenditure trends.*

*We have studied the budget process while focusing on the presentation of budget documentation and information available at different stages. Special attention was given to how the Parliament participates in the budget decision-making process, its interaction with the Government and to public awareness.*

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## PUBLIC POLICY RESEARCH CENTER



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*Dear Readers,*

We offer for your attention findings of the study on budget process in Kazakhstan and Azerbaijan. The study was carried out by the Public Policy Research in cooperation with the colleagues from Public Finance Monitoring Center in Baku.

Study outcomes were discussed at the Roundtable «Budget Process in the Caspian Countries: Experience of Kazakhstan and Azerbaijan» organized by our Center on 21 January 2005 in Almaty. Among the roundtable participants were the Chairs of the Commissions on Finance and Budget of the Senate and Majilis of the Parliament of the RK, representatives of the Counting Committee on Control of Republican Budget Implementation, Ministry of Economy and Budget Planning, Embassies of Great Britain, Poland, Germany, international organizations, research institutes, NGOs, mass media and experts.

The study undertaken in Kazakhstan and Azerbaijan was the next step following a wider analytical review in 36 countries carried out by the International Budget Project of the Center for Budget and Policy Priorities/CBPP, Washington, USA. G. Saint-George, CBPP chief expert on budget, was invited in order to present study outcomes to the roundtable participants. In his statement G. Saint-George mentioned: «When civil society participates in budget process, economy functions better, democracy develops, and as a result, the State experiences positive changes. Budget is the most important economic and social document produced by any government. Budget is the key to economic growth and prosperity of any country. Possibility of good budget significantly increases, if community is involved in this process. If one person writes the budget, on his/her behalf, there is little chance it reflects wide range of interests of the whole society. Community involvement into budget process promotes accountability. Governments become more accountable if the budget is transparent».

We thank our colleagues from the International Budget Project and Public Finance Monitoring Center for fruitful collaboration as well as Soros Foundation – Kazakhstan for financial support of this joint research project.

We hope this publication will attract attention of those who is interested in budget reforms in transition countries.

Editor-in-Chief



Meruert Makhmutova

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## *Abbreviations*

**CBPP** – Center for Budget and Policy Priorities

**DBK** – Development Bank of Kazakhstan

**IBP** – International Budget Project

**IMF** – International Monetary Fund

**JSC** – Joint Stock Company

**GDP** – gross domestic product

**MP** – Member of the Parliament

**NGO** – non-governmental organization

**OECD** – Organization on Economic Cooperation and Development

**SOFAR** – State Oil Fund of Azerbaijan Republic

**SOCAR** – State Oil Company of Azerbaijan Republic

**PFMC** – Public Finance Monitoring Center

**PPRC** – Public Policy Research Center

**VAT** – value-added tax

## Summary

This paper presents findings of the study on budget transparency in Kazakhstan and Azerbaijan; the study was carried out in 2004 by the Public Policy Research Center in cooperation with the Public Finance Monitoring Center (Baku, Azerbaijan). Special attention was given to how the Parliament participates in the budget decision-making process, its interaction with the Government and to the public awareness.

Methodology was based on approaches developed by the International Budget Project of the Center for Budget and Policy Priorities (Washington, USA) while evaluating budget process using IMF *Code of Good Practices in Fiscal Transparency* and document of the Organization for Economic Cooperation and Development *OECD Best Practices for Budget Transparency*. Our involvement in the study «Opening budgets to public understanding and debate», which was carried out by the International Budget Project in 36 countries, helped to assess budget practice of Kazakhstan and Azerbaijan.

The significance of the study is that practical recommendations were developed based on the study outcomes; the recommendations reflect key financial (economic) indicators during preparation of the budget documentation, strengthening of the Parliament role in the budget process, improvement of budget process in Kazakhstan and bringing it closer to the international standards set in the IMF *Code of Good Practices in Fiscal Transparency* and *OECD Best Practices for Budget Transparency*.

# Budget Process in the Caspian Countries: Experience of Kazakhstan and Azerbaijan

*Meruert Makhmutova*

## Introduction

The state budget is one of the major tools of state policy implementation. Budget policy should promote effective governance, ensure social equity, economic and political stability. Whether these goals are achieved depends on the transparency of budget decision-making.

### ***What does it mean?***

The document of the Organization for Economic Cooperation and Development *OECD Best Practices for Budget Transparency* (hereinafter *Best Practices*) provides the following definition: «Budget transparency is defined as the full disclosure of all relevant fiscal information in a timely and systematic manner».

***Budget transparency is defined as the full disclosure of all relevant fiscal information in a timely and systematic manner***

### ***Why is it important?***

A lack of integrated and reliable information hampers the evaluation of budget policy and its implementation consequences. In the aftermath of the Asian crisis in 1998 the International Monetary Fund (IMF) developed the *Code of Good Practices in Fiscal Transparency* (hereinafter *Code*) accounting for the negative experience of those countries, where governments did not provide full fiscal information and in that way hampered a timely and adequate policy evaluation.

The following four general principles of fiscal transparency constitute a basis of the *Code*:

- the first principle – clarity of roles and responsibilities – is concerned with specifying the structure and functions of government, responsibilities within government, and relation between government and the rest of the economy;
- the second principle – public availability of information – emphasizes the importance of publishing comprehensive fiscal information at clearly specified times;

- the third principle – open budget preparation, execution and reporting – covers the type of information that is made available about the budget process;
- the fourth principle – assurances of integrity – deals with the quality of fiscal data and the need for independent scrutiny of fiscal information.

The IMF published a *Manual on Fiscal Transparency* (hereinafter *Manual*) in order to clarify *Code* requirements to support IMF state members in assessing fiscal transparency. Both these documents contain practical criteria for assessment of fiscal transparency.

In December 2002 the International Budget Project<sup>1</sup> designed a questionnaire on budget transparency. The questionnaire was based on the *Code*, *IMF Manual on Government Finance Statistics* and *Best Practices*. As a tool of assessing budget transparency it was introduced for the expert poll. The questions were to be answered based on empirical survey not on separate observations or personal opinions. Experts from 36 countries including Kazakhstan (Public Policy Research Center) and Azerbaijan (Public Finance Monitoring Center) completed the questionnaire. Participation of our experts in the joint survey helped to evaluate success of budget reforms and identify existing problems.

Even though the questionnaire on budget transparency was designed in a way applicable to any country, in a number of cases certain questions were not applicable to specific conditions of our countries. The joint project focused on fiscal policy transparency in Kazakhstan and Azerbaijan in order to identify the real degree of budget transparency.

#### **Why Kazakhstan and Azerbaijan were chosen as the study subject?**

*In 2004 GDP in Kazakhstan reached \$ 40.7 billion, in Azerbaijan – \$ 8.5 billion*

Before 1991 Kazakhstan and Azerbaijan were a part of the Soviet united budget system. The collapse of the Soviet Union and proclaimed independence allowed the Republics to formulate independent fiscal policies. Both countries carried out a number of budget reforms.

As a result of the implemented reforms the budget organization was modified and a new legislative base was formed. Additionally, a budget revenues policy was developed (including tax and non-

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<sup>1</sup> This program brings together research centers and NGOs involved in budget work in 57 countries.



tax revenues) and state expenditures were optimized. As debts were accumulated it became necessary to develop a debt policy. The new institutions were established: Treasury and Supreme Audit bodies. In Kazakhstan Treasury was established in 1995, in Azerbaijan – in 1998. In Kazakhstan the Counting Committee on Monitoring of Republican Budget Implementation was established in 1996 by the President's Decree, in Azerbaijan – the Counting Chamber was established by the Parliament (Milli Medjlilis) in 2001.

Since 2000 Kazakhstan and Azerbaijan economies were demonstrating high growth rates due to escalating hydrocarbon production and high prices on them in the world markets. Economy's dependence on oil can be seen in the following data. In 2003 23.8% of Kazakhstan's GDP was provided by oil sector,<sup>2</sup> in Azerbaijan the oil sector's share provided 27.7% of GDP.<sup>3</sup>

In 2004 alone oil prices increased by 38% in the world markets according to the IMF data. In 2004 GDP in Kazakhstan reached \$ 40.7 billion (growth by 9.2%), in Azerbaijan – \$ 8.5 billion (growth by 10.2%). Macroeconomic indicators for 2004 for both countries are provided in the Annex Table 1.

The budget revenue of both countries depends on oil. In 2004 in Kazakhstan the oil sector share in state finances made up 29% (Table 1). In Azerbaijan in 2004 oil sector provided 47% of state budget revenues.

*In 2003 23.8% of Kazakhstan's GDP was provided by oil sector, in Azerbaijan the oil sector's share provided 27.7% of GDP*

*Table 1. Oil Sector Revenue Share in State Revenues, in %*

	Kazakhstan*				Azerbaijan**			
	2001	2002	2003	2004	2001	2002	2003	2004
Oil sector								
revenue, total	30.5	28.2	28.7	29	61.0	68.9	62.3	47.0
Including to the								
State budget	21.1	16.4	10.3	15	34.0	36.5	32.6	33.8
To the Oil								
Fund	9.4	11.8	18.4	14	27.0	32.4	29.7	13.3

Sources: data of the \*Ministry of Economy and Budget Planning RK, \*\*Ministry of Economy AR and Public Finance Monitoring Center.

<sup>2</sup> As per data of the Ministry of Economy and Budget Planning RK, oil production makes 8.6 % of GDP, goods and services for oil production provide another 15.2 % of GDP.

<sup>3</sup> Data of the Ministry of Economy of Azerbaijan: [www.economy.gov.az](http://www.economy.gov.az).

***Budget  
transparency is a  
pre-requisite for  
democratic and  
accountable  
government***

In order to accumulate revenues from the raw materials the Presidents of both countries established the State Oil Fund of Azerbaijan Republic (SOFAZ) in December 1999 and the National Fund of the Republic of Kazakhstan in August 2000.

The revenues from natural resources should be spent on improving living standards and poverty reduction, which would lead to sustainable economic growth. This will be possible if budget provides complete information on the channels of revenue and expenditure trends. It is very important to ensure transparency of budget policy, balance of interests of the main participants of the budget process, auditing by the Counting Committee, Parliament participation in the budget process and raising public awareness on the subject.

Budget transparency is a pre-requisite for democratic and accountable government. Civil society organizations involved in budget analysis depend on official information when they study budget and its implementation. Such a study might help them to identify information available to the society, whether it is timely at each stage of the budget process and to uncover information gaps.

To what extent budget reforms brought our countries closer to transparent budget policies? To what extent Kazakhstan's and Azerbaijan's budget practices comply with the *Code* and *Best Practices*? We have studied budget process while focusing on the presentation of budget documentation and information available at different stages. Special attention was given to how the Parliament participates in the budget decision-making, its interaction with the Government and to public awareness.

***Methodology***

Our assessment of budget transparency in Kazakhstan and Azerbaijan used criteria from the following documents:

- *Code of Good Practices on Fiscal Transparency, IMF;*
- *Manual on Government Finance Statistics, IMF;*
- *OECD Best Practices for Budget Transparency.*

For analysis of budget in Kazakhstan:

- Draft Republican Budget for 2004 submitted by the Government for Parliament consideration;

- The Government's Report on Implementation of the Republican Budget for 2003;
- Report of the Counting Committee on Implementation of Republican Budget for 2003.

An assessment of budget transparency in Azerbaijan is based on responses provided by our colleagues from the Public Finance Monitoring Center (in answers to the *Open budget questionnaire* of the International Budget Project). All budget documentation in Azerbaijan is in Azeri only, therefore, it was not possible to read it. We have studied sites of the relevant state bodies.<sup>4</sup> We studied IMF Reports on evaluation of fiscal transparency: in Kazakhstan (October 2002) and in Azerbaijan (November 2000) to take into account changes which took place during the last few years.

Confusion should be avoided when comparing budget systems in Kazakhstan and Azerbaijan since similar names are used to define different budget components in these two countries. In Kazakhstan the Government develops a Draft Republican Budget to be approved by the Parliament. State budget consolidates republican and local budgets without account of balancing out operations between them. It is used as a source of analytical information and does not require approval. Local budgets, in this particular case, mean budgets of 14 Oblasts as well as Almaty and Astana Cities (which have a special status).

Azerbaijan's budget system includes state budget, budget of Nahchyvan Autonomous Republic and local (municipal) budgets. The Government prepares state budget for the Parliament's approval – this is the budget of Central Government, it excludes budgets of municipalities.

## 1. Budget Documentation

### 1.1. Pre-Budget Report

A publication of a preliminary budget report – a so called Budget Address – is used to stimulate debate on the budget and to form appropriate budget-related expectations. This document should contain the Government's long-term economic and fiscal policy objectives and economic and fiscal policy tasks for the forthcoming

*The President of Kazakhstan presents an annual address to the people, in which he identifies the main budget priorities*

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<sup>4</sup> A list of web-sites of relevant state bodies is provided in the Annex.

*In Azerbaijan there is no practice of a Budget Address being presented*

budget and for, at least, two following fiscal years. It should highlight the total level of revenue, expenditures, deficit or surplus, and debt. Ideally, a Budget Address should be published not later than one month before a draft budget is presented.

In Azerbaijan there is no practice of a Budget Address being presented.

The President of Kazakhstan presents an annual *Address to the people about the situation in the country and major trends in domestic and foreign policies* (hereinafter *Address*), in which he identifies main budget priorities.<sup>5</sup> Before 2001 the President presented his *Address* in autumn; since 2002 the *Address* is presented in spring in order to integrate goals set in the *Address* into the draft budget for the coming year. However, in practice, this resulted in annual budget amendments, which destabilized the budget process.<sup>6</sup> Following amendments to the Republican budget the local budgets at every level – Oblast, Rayon, City – have to be amended. It appears that the Government is not concerned with the real revenue forecast when planning the coming year budget – this way it can use the resources hidden from the Parliament for implementation of initiatives proposed by the President in his *Address* six months after.

Since this is not a Budget Address, it lacks macroeconomic and financial information; it does not reflect general level of revenue, expenditures, budget deficit or surplus, and debt. The *Address* contains government policies and priorities.

## **1.2. Medium Term Budget Frameworks**

The IMF *Manual* suggests that publication of complex sliding medium term budget frameworks (for 3-5 years) should be the basis for managing state finances.

According to the Budget Code adopted in 2004 the Government for the first time issued *Mid-Term Fiscal Policy of the*

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<sup>5</sup> Budget Code RK (which entered into force on 1 January 2005) legalized this tradition in the article 55, p. 4.

<sup>6</sup> A growth in annual budget indicators during its implementation resulted in the Government's underspending of projected expenditures. A budget revenue increased in June 2003 by Tenge 78.6 billion, the amount of underspent assets amounted to Tenge 40.3 billion in 2003, in 2004 expenditures in mid-year were increased by Tenge 58.0 billion, the amount of underspent assets increased to Tenge 41.0 billion by the end of the year.

*Government of the Republic of Kazakhstan for 2005-2007.* The Government plans to issue such document annually and to introduce it along with the draft budget to the Parliament.

The contents of this document reminds an accompanying note, which previously was attached to the draft Republican budget when it was introduced by the Government to the Parliament. Now it is a more extensive document as it covers not one but three years.

Development of this document made possible an analysis of budget prospects proposed by the Government. However, its content has the same shortcomings as in the process of information disclosure in drafting the budget (more details are provided in the following sections).

Since the purpose of publishing budget documentation lies in stimulating active debates on consolidated budget indicators and formulating relevant expectations in the society, it makes sense to review the date of its presentation and to introduce it to the Parliament separately, at least three months before the submission of the draft budget.

For example, in the South-African Republic macroeconomic preconditions, which provide basis for general budget forecast, are covered in the Statement on mid-term budget policy. This Statement is sent to the Parliament three months before the introduction of the budget.

*The IMF Manual suggests that publication of complex sliding medium term budget frameworks should be the basis for managing state finances*

### *Medium Term Budget Framework*

*Medium term budget framework provides a very clear statement of the revenue and expenditure effects of maintaining current government policies, and a mechanism for controlling the introduction of new policies and tracking budget implementation beyond a single year. It provides a transparent basis for accountability of the executive branch, and a necessary foundation for more detailed results-oriented budgeting. Medium term frameworks have been used successfully by Germany, the United Kingdom and Australia.*

*Source: Manual on Fiscal Transparency. – Washington, District Columbia: International Monetary Fund, Fiscal Affairs Department. – 2001. – p. 42.*

### 1.3. Draft Budget

*A draft budget should be submitted to the Parliament not later than 3 months before the fiscal year*

The key event in the budget process is the Government's introduction of the draft budget for the Parliament's consideration. In accordance with the OECD *Best Practices* the Government's draft budget should be submitted to the Parliament sufficiently in advance to allow the Parliament to properly review it. In no case should this be less than 3 months prior to the start of the fiscal year. According to the budget calendar effective during the time of the study, the Government was supposed to introduce a draft budget to the Parliament before September 15. Currently the Government should present a draft republican budget to the Parliament not later than 1 September in accordance with the Budget Code.<sup>7</sup>

Current legislation in Azerbaijan also allocates a time frame of three months for the Parliament to discuss the budget submitted annually by the Government not later than October 15. Time left till the end of the year is not sufficient for a full scale discussion of the budget both within the Parliamentary Commission for Economic Policy and during the general sessions of the Parliament. Since autumn 2003 – due to amendments in legislation – the Government increased the number of documents to be submitted along with the budget in 10 times. This development hampered analysis and discussion of these documents during such a short time.

*A draft budget should cover all budget and extra-budget operations of the Government*

According to the *Code* and *Best Practices*, a draft budget should cover all budget and extra-budget operations of the Government. The budget and all attached documents should include detailed comments to each channel of revenues or expenditures. It is recommended that expenditures are classed as economic, functional and administrative. The information should include results of two last financial years together with a budget forecast for the next two years. Current budget proposal should be compared with a forecast made in the earlier budget documents for the same period, all deviations should be justified. Each line should have comparisons of actual income and expenditures for the last year and an updated forecast for the current year.

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<sup>7</sup> The Parliament has not changed terms of budget consideration, as now the Parliament should approve it not later than 1 December.

A draft budget has to include a brief summary of the budget and its prospects. The summary is very important because a budget is usually a bulky and complex document, and a short budget summary consolidates all its contents in a brief form.

As was mentioned earlier this study assessed the draft budget for 2004, introduced by the Government to the Parliament. The draft republican budget in Kazakhstan covers budget revenues within the following categories:<sup>8</sup>

- 1) tax revenues grouped by types of taxes, fees and other compulsory payments;
- 2) non-tax revenues grouped by types of revenues, fees and levy, fines and sanction payments, credit interest;
- 3) benefits from capital circulation grouped by types of sold property and other state assets;
- 4) received official transfers – free and irretrievable income received by the budget, excluding grants;
- 5) repayment of credits – the amount of major debt repaid for credits allocated from the budget, with breakdown by repayment of internal credits, refund of demands by paid state guarantees, sale of the state shares abroad and repayment of external credits.

*A draft budget has to include a brief summary of budget and its prospects*

All expenditures of the Republican budget are grouped in a draft budget on the basis of *functional and administrative classification*; expenditures are not presented by *economic classification*. There is also no clarification of expenditures at the programme level; only general current budget programmes and development programs are listed.

A comparison of current year budget expenditures (an updated plan) with the probable indicators for the next year budget and a deviation of actual implementation from the forecast are presented in a comparative table (grouped by functional expenditures).

When submitting a draft budget in Azerbaijan the Government indicates the sources of revenue, tax and non-tax income in accordance with levy sources. State budget expenditures in the draft are grouped on the basis of *functional, economic*

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<sup>8</sup> Such income categories were used until they were changed in 2004.



*and administrative classification* of expenditures. Nevertheless, a classification of expenditures requires international standard details. The draft budget does not classify expenditures at programme level also.

In Kazakhstan the draft budget only contains information about a debt limit by the end of the year, a limit of state guarantees for the next year, as well as assets to be channeled for debt servicing, cancellation and servicing of state guaranteed loans (only total amount is indicated). There is no real evaluation of a state debt classified in accordance with debt currency denomination, indication of debt composition, interests (variable or fixed), conditions and terms of debt discharging. Expected expenditures for debt servicing are neither divided by expenditures for major debt and interest payment, nor by internal and external obligations.

No information is presented on management tools to be used for debt discharge. The cost of servicing US dollar loans allocated from the budget is growing due to strengthening of Tenge against US Dollar, however, budget documentation lacks any evaluation of expected expenditures in Tenge.

The Government does not indicate in the budget or explains to the Parliament a growth of internal debt, which happens despite a budget surplus. An accretion of internal debt (from Tenge 121.8 billion by 01.01.2003 to Tenge 231 billion by 01.01.2005) happens due to a regular issue of securities by the Ministry of Finance of the RK.

*In Azerbaijan a  
draft state budget  
should be published  
in the press*

In Azerbaijan the draft state budget shows the amount of state debt as per beginning of July of the current budget year. It lacks forecasts related to new loans to be made until the end of the current year. The expected repayments of state debt are divided by expenditures on the major debt and repayment of interest as well as by internal and external obligations. Information on donor assistance sources is presented. Moreover, main debtors are shown (for example, the government or economy sectors receiving international credits on a state guarantee). However, neither the schedule/terms of debt discharge nor currency of new loans and cancellation are presented.

According to the Law of Azerbaijan Republic *On Budget System*, a draft state budget for the next year and relevant



budget package documents should be published within 10 days after the Government submits it to the Parliament.

In Kazakhstan a draft budget is not published.

As earlier, the contents of a draft republican budget and accompanying documents set in the Budget Code does not comply with the IMF and OECD requirements on budget transparency.

### ***An assessment of budget implementation in previous years***

The IMF *Code* recommends to present comprehensive information on previous, current and forecasted Government fiscal activities to the public. Information on the outcomes of budget implementation for the last two years should be presented in the budget draft or supporting budget documentations for a more clear indication of current budget status.

In Kazakhstan information on budget implementation during the previous years and detailed information on budget implementation during the current year is not included into budget documentation package to be submitted by the Government to the Parliament. It is available on the web-site of the Ministry of Finance and in the Ministry's publications. However, submission of such information along with a budget package would help members of the Parliament to follow the dynamics of state revenues and expenditures.

The Government of Azerbaijan submits to the Parliament a draft budget for the next year along with the data on the three preceding years. As for data on the current year, forecasted and actual data on budget revenues and expenditures within nine months and expected outcomes of budget implementation till the end of the year is presented. Data on current budget year and on the past years is aggregated and then classified by functional, administrative and economic classification.

As in case with the data on the budget year, data on budget implementation within previous years lacks information on program-level expenditures. Apart from expenditures, budget documentation contains information about budget revenues for two and more years preceding the budget year. Submitted data can be aggregated and classified by tax and non-tax revenues. They all reflect actual outcomes of budget implementation.

***In Kazakhstan a draft budget is not published***

***The Government of Azerbaijan submits to the Parliament a draft budget for the next year along with the data on the three preceding years***

### *A budget assessment for the following years*

In accordance with the *Best Practices* a draft budget should cover mid-term prospects and show dynamic of main consolidated budget revenues and expenditures for the two budget years following the current budget year.

In Kazakhstan a forecast of budget revenues (tax and non-tax incomes, revenues from capital circulation, official transfers and credit repayment) and expenditures for the three following years is presented in a form of aggregated evaluation as GDP share, without functional, economic and administrative classification. The forecast does not itemize revenues (sources of tax and non-tax revenues etc.) and expenditures.

A forecast of revenues and expenditures for the three following years in Azerbaijani draft state budget is neither aggregated nor presented with more details.

### **1.4. Monthly Reports**

*Monthly reports showing progress in budget implementation should be published within four weeks from the end of each month*

The IMF *Code* states that for an effective management timely and reliable current information on state finances is required throughout the year. Monthly reports showing progress in budget implementation in accordance with the OECD *Best Practices* should be published within four weeks from the end of each month.

«They should contain the amount of revenue and expenditure in each month and year-to-date. A comparison should be made with the forecast amounts of monthly revenue and expenditure for the same period. Any in-year adjustments to the original forecast should be shown separately.

A brief commentary should accompany the numerical data. If a significant divergence between actual and forecast amounts occurs, an explanation should be made.

*Monthly reports on budget implementation should classify expenditures by the major administrative units*

Expenditures should be classified by major administrative units (e.g., ministry, agency). Supplementary information classifying expenditures by economic and functional categories should also be presented. The reports, or related documents, should also contain information on the government borrowing activity», – the OECD document recommends.

In Kazakhstan monthly reports on implementation of the state, republican and local budgets are published in Kazakh and Russian

on the web-site of the Ministry of Finance: [www.minfin.kz](http://www.minfin.kz), and also in the Ministry's *Statistical Bulletin*, which is distributed by subscription or can be downloaded from the Ministry's site within one month from the end of the reporting period.

The *Statistical Bulletin* publishes major macroeconomic indicators by the current date and for the three previous years. A report on implementation of state and republican budget is compared with the approved<sup>9</sup> budget for the year, a rate of implementation is presented in percentage against the annual budget, budget implementation in current year is compared with the same period of the previous year. Moreover, the *Bulletin* presents data on implementation of revenues and expenditures of state and republican budgets in a quarter dynamic for current and previous years, as well as annual aggregated indicators for the two previous years. A detailed report on up-to-date state budget revenues is presented within major revenue categories,<sup>10</sup> expenditures of state budget are classified by administrative and economic classifications.

A detailed report on republican budget revenues is also presented in major revenue categories, expenditures implementation is classified by administrative and economic classifications.

The *Bulletin* also publishes a monthly report on the governmental and state guaranteed debt with an identification of internal and external debt. The internal debt is divided by source; the external debt is itemized by international institutions and countries-creditors. To find out which part of these loans belongs to the current year is only possible if monthly reports are compared. The *Bulletin* does not offer any information on interest rates of the debt, repayment dates and currency denomination for the budget year. The expenditures for debt

*In Kazakhstan current reports on implementation of state, republican and local budgets are published monthly in Kazakh and Russian on the web-site of the Ministry of Finance and also in the Ministry's Statistical Bulletin*

*In Azerbaijan monthly reports on budget implementation are published only for administrative use and are not open to public*

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<sup>9</sup> In case of changes, a comparison is made against the amended budget.

<sup>10</sup> In accordance with the Rules on Unified Budget Classification (Decree of the Government RK as of 14 September 2004 №959), a classification of budget revenue includes following major categories: 1) tax revenue; 2) non-tax revenue; 3) revenue from sale of fixed capital; 4) revenue of official transfers; 5) cancellation of budget credits; 6) revenues from sale of state financial assets; 7) loans income; 8) movement of finances leftovers.

servicing are divided neither by the expenditures on main debt and interest payment nor by internal and external obligation.

The *Bulletin* also contains information on state budget financing by creditor's type and debt obligations, implementation of Oblast budgets, budget withdrawals and subventions of the republican budget, the non-sequester lines of the republican budget, investment programmes of the republican budget, debts of creditors and debtors to the state budget, distribution of state securities, selling of state shares in different enterprises and republican state property.

Besides the information on republican, state and local budgets the *Statistical Bulletin* publishes information on portfolio composition and distribution of the National Fund RK assets. Each issue contains information about the results of checks carried out by the Committee for Financial Control (the Ministry of Finance).

In Azerbaijan monthly reports on budget implementation are published only for administrative use and are not open to public. Only limited information might be obtained from the official newspapers, data of the State Committee for Statistics on aggregated revenues, expenditures and budget surplus. A comparison of actual data on budget implementation against the forecasted, data on the government loans and state debt is not published.

### 1.5. Mid-Year Report

*Mid-year report provides a comprehensive update of the budget implementation, including an updated forecast of the budget outcome*

According to the *Best Practices*, a mid-year report provides a comprehensive update of budget implementation including an updated forecast of the budget outcome for the current fiscal year and for, at least, two following fiscal years. The report should be released within six weeks from the end of the mid-year period.

The economic assumptions underlying the budget should be reviewed and the impact of any changes on the budget is to be disclosed.

*Mid-year reports are not published in Kazakhstan. The report on the results of the half year plays the role of such report*

A mid-year report should contain a comprehensive discussion of the government financial assets and liabilities, non-financial assets, employee pension obligations and contingent liabilities. The influence of any other government decisions or other circumstances that may have a significant impact on the budget should be disclosed.

Such mid-year reports are not published in Kazakhstan. The reports on the results of half-year activities (January-June) play the role of such reports. This half-year report as any other monthly report can be found on the web-site and in the relevant issue of the *Statistical Bulletin*. This report does not meet the requirements for the mid-year reports. Neither economic assumptions – the basis of the budget, nor their influence on budget implementation or influence of any other decisions of the Government on budget indicators are studied. It lacks discussion on financial assets and liabilities, non-financial assets, quasi-fiscal operations, quantitative evaluation of programme beneficiaries and contingent liabilities.

*In Azerbaijan half-year reports on budget implementation are neither published nor open for public*

In Azerbaijan mid-year reports on budget implementation are neither published nor open for public.

## **1.6. Year-End Report**

The main document on the Government's accountability is the year-end report. It should demonstrate whether the state budget's real revenues and expenditures correspond to the levels of revenues and expenditures authorized by the Parliament. Any in-year adjustments to the original budget should be separately indicated.

Expenditures should be classified by administrative unit (e.g., ministry, agency). It is also necessary to present supplementary information on expenditures classified by economic and functional categories. «The year-end report should contain a comprehensive discussion of the government financial assets and liabilities, non-financial assets, employee pension obligations and contingent liabilities», – *Best Practices* recommends.

*The year-end report should contain a comprehensive discussion of the government financial assets and liabilities, non-financial assets, employee pension obligations and contingent liabilities*

The report should be audited by the supreme audit body of the country. The best practice is when the Government submits this report to the Parliament not later than six months after the budget year comes to an end.

In earlier years the Government of Kazakhstan submitted a report on the republican budget implementation to the Parliament after the end of the financial year before 15 May, now – before 1 May. Apart from the report itself the Government also submits an explanatory note to the budget, information on formation and utilization of the National Fund, on grants received and spent by state institutions.

*The annual report should be audited by the supreme audit body of the country*

The report's format reflects the format of the budget itself: it presents an analysis of the article by article implementation of the Law *On Republican Budget for 2003* with the basic data and actual implementation levels.

The Government's year-end report does not contain analysis on discrepancies between the original macroeconomic forecast for 2003 and the actual indicators of the republican budget.

The report compares the actual budget's revenues with the initially approved level (including adjustments made during the year, approved by the Parliament), and explains the discrepancies. Revenues are divided into tax and non-tax categories and are grouped by capital circulation, «received official transfers» and «credit repayment».

The implementation of the republican budget expenditures is demonstrated within the programme-level: data is given both in money terms and percentage against the planned size. The report provides information on differences between the initially approved expenditures and the actual indicators. Current budget programmes and development programmes show data on actual implementation and any deviations from the initially approved level. There are no programme details.

*A year-end report in Kazakhstan lacks disclosure of financial assets and liabilities, non-financial assets, quasi-fiscal operations, evaluation of budget programme beneficiaries*

The reference note in the submitted documentation clarifies implementation of separate contingent liabilities – utilization of the Government's reserves as allocated in the budget.

However, a year-end report lacks disclosure of financial assets and liabilities, non-financial assets, quasi-fiscal activities, evaluation of budget programme beneficiaries.

The explanatory note attached to the report on implementation of the republican budget provides detailed information on budget revenues and expenditures by functional groups, the budget programme implementation is considered within their framework. For example, the General State Services expenditure group provided for 142 budget programmes: the implementation of each of them and the summary is provided as along with an explanation of the deviations.

The report of the Government to the Parliament also presents results of the internal audit carried out by the Ministry of Finance of RK.

Annual reports on implementation of the republican and local budgets in Kazakhstan are published on the web-site of the Ministry of Finance at [www.minfin.kz](http://www.minfin.kz) and in the *Statistical Bulletin*. However, unlike the same reports presented to the Parliament, this report is less detailed and does not follow all requirements for annual reports as outlined in the *Code* and *Best Practices*. Therefore, published reports do not provide information about expenditures by programmes; do not explain differences between planned and actual revenues and expenditures.

In Azerbaijan the report on state budget is not published. Annually, during six months after the end of the financial year the Government publishes the *Law On State Budget Implementation* after it was adopted by the Parliament and signed by the President.

A law *On Budget Implementation* has only functional classification of all the revenue and expenditure lines without economic and administrative classification. Only actual data is given on revenues and expenditures and they are compared neither with the initial and adjusted forecasts nor with the same indicators of the last year. The *Law On Budget Implementation* does not cover amendments introduced to the budget during the year. It neither covers financial and non-financial assets, employee pension obligations nor contingent liabilities of the Government.

*In Azerbaijan the report on state budget is not published ...*

*... during six months after the end of the financial year the Government publishes the Law On State Budget Implementation*

## 2. Specific Disclosure

### 2.1. Economic Assumptions

The OECD recommends clarifying all economic assumptions. This relates to the GDP growth forecast, the components of the GDP growth, the levels of employment and unemployment, the current account balance, inflation rates and interest rate (monetary policy).

A draft budget in Kazakhstan is submitted to the Parliament along with an explanatory note, which contains macroeconomic basis for the budget forecast. The draft budget for 2004 presents data on implementation of the last year budget (2002), an evaluation of the current year (2003) and a forecast for 2004-2006 by the following indicators: GDP and its growth rate, an average annual inflation rate, an average annual exchange rate of Tenge to USD, export and import volume, world oil price



*Fluctuation of world prices on crude oil is a risk factor for Kazakhstan and Azerbaijan*

(Brent) and export oil price. Other indicators – employment and unemployment rates, a current account balance and interest rates remain undisclosed.

A draft state budget in Azerbaijan also has information on macroeconomic basis of the budget. It presents data on forecasted GDP, investment, export, import size and social indicators.

The risks should be revealed along with the forecasts. IMF recommends identifying fiscal risks and providing quantitative evaluation, including modification of economic assumptions and expenses ambiguity by concrete expenditure obligations. The budget sensitivity to the influence of key economic assumptions modification should be analyzed.

In Kazakhstan and Azerbaijan draft budgets do not contain fiscal risks analysis, do not provide information about the possible influence of different macroeconomic factors on budget implementation. Among such factors: change in GDP, the volume of export and import, national currency rate, level of inflation, etc. Fluctuation of world prices on crude oil is a risk factor since a major part of our countries' budgets – as was mentioned earlier – relies on revenue from the oil sector.

Explanation to draft budget does not cover forecasted budget losses or additional earnings due to fluctuation of exchange rate or oil prices. There are no sensitivity calculations, showing influence of interest rates and exchange rate change (strengthening of Tenge to Dollar, Euro, Yen) on financial expenses.

## **2.2. Extra-Budget Funds**

The Government's budget activity should be fully open to the Parliament and the public. Timely and comprehensive information about all state financial flows is especially important since a lack of transparency and poor governance provides fertile ground for corruption.

The extra-budget funds accumulate specifically reserved earnings. Some countries accumulate resources for retirement and social insurance programmes in the extra-budget funds. In some cases political goals justify establishment of extra-budget funds. The activity of such funds is well documented. However, sometimes this division causes information

*The Government's budget activity should be fully open to the Parliament and the public*



suppression; often there is no information or very scarce information about such funds, – IMF notes in the *Manual*.

In Kazakhstan there was the only extra-budget fund at the time of study – the National Fund of the Republic of Kazakhstan.<sup>11</sup> Only very general information on the National Fund is available in the draft republican budget and the annual report – only the amount of transfers to the National Fund from the republican budget and a forecasted size by the end of the year are provided. There is no data on the National Fund expenditures. The government also fails to provide consolidated evaluation of revenues and expenditures of the state budget with the National Fund being included; and it does not identify deficit (surplus) in the budget documentation. The President approves the report of the National Fund; the Government submits to the Parliament information only on the inflow of funds to the National Fund and their utilization along with the report on the republican budget.

The fact that from 2004 the draft consolidated budget reflects revenue and expenditures of the extra-budget funds can be considered as a progress in Azerbaijan, the extra-budget funds come from the State Oil Fund of Azerbaijan Republic (SOFAR) and the State Fund for Social Protection of Population (SFSP). The consolidated budget, which reflects aggregated revenues and expenditures of SOFAR and SFSP, allows to evaluate general revenues and expenditures of the state sector and to identify deficit. However, it is impossible to select specific SOFAR expenditures in the draft consolidated budget. For example, it is not possible to define if oil-dollars are directed for social needs, social infrastructure or other aims.

The draft consolidated budget in Azerbaijan includes extra-budget expenditures of the organizations funded from the state budget, apart from the aggregated revenue and expenditure indicators of the state budget and two extra-budget funds. The SFSP draft budget is also attached; it concretizes revenue and expenditure. The SOFAR draft budget with a detailed revenues and expenditures is not submitted to the Parliament but directly

*The Government also fails to provide consolidated evaluation of revenues and expenditures of the state budget with the National Fund being included; and it does not identify deficit (surplus) in the budget documentation*

*The fact that from 2004 the draft consolidated budget reflects revenue and expenditures of the extra-budget funds can be considered a progress in Azerbaijan*

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<sup>11</sup> According to the Budget Code, the National Fund became the part of budget system from 1 January 2005. In 2004 a new extra-budget fund was established – the State Foundation for Social Insurance.

*The fact that the oil funds are subordinated and accountable only to the President is typical both for Kazakhstan and Azerbaijan*

*The size and purpose of transfers from the budget to other levels of state governance or state corporations should be provided in relevant documents*

*... finances flow from the state budget to quasi-budget institutions*

to the President. At the same time, the draft budget is placed at SOFAR's web-site and is in public domain.

The fact that the oil funds are subordinated and accountable only to the President is typical both for Kazakhstan and Azerbaijan. The Parliament's involvement in oil funds management is nominal,<sup>12</sup> as they do not approve reports on implementation and auditors' reports. Both countries lack legal and economic criteria for transfers from the oil funds to the budget.

### **2.3. Transfers from the Budget**

Transfers from the budget to other levels of state governance or state corporations should be reflected in the draft budget and other budget documents. The size and purpose of such transfers should be provided in detail.

The information about transfers to other levels of state governance and state corporations in Kazakhstan is provided without significant details.

Absolute subventions, withdrawals, targeted transfers to local budgets are planned in the budget; however there is no methodical justification for budget equalization. Moreover, targeted transfers to local budgets for specific goals are itemized: wages for staff of state secondary education institutions, development of small cities with depressive economy, maintenance of new education and health institutions.

An establishment of different funds and other economy subjects in a form of joint-stock companies (JSC) by budget resources is very common in Kazakhstan. Annual amendments increasing republican budget revenues are followed by the stock capital increase in these organizations. As a result, finances flow from the state budget to quasi-budget institutions. In the draft budget for 2004 Tenge 12.2 billion were planned for formation and replenishment of stock capital of the following organizations:

- JSC «State Fund for Social Insurance» – Tenge 46 million;<sup>13</sup>

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<sup>12</sup> The representatives of the Chambers of the Parliament of RK are the members of the Council on National Fund Management, which is a consultative and advisory body under the President of RK and does not have a decision-making authority.

<sup>13</sup> Later – during the process of budget approval – that figure increased to Tenge 3.5 billion.

- JSC «Kuigenjar» – Tenge 275 million;
- JSC «International Airport of Astana City» – Tenge 2.6 billion;
- JSC «Kazakhstan Contract Agency» – Tenge 93 million;
- JSC «Engineering and Transfer Technologies Center» – Tenge 400 million;
- JSC «Center for Marketing and Analytical Research» – Tenge 766 million;
- JSC «National Innovation Fund» – Tenge 6.5 billion;
- JSC «Fund for Development of Small Entrepreneurship» – Tenge 750 million;
- National company «Kazakhstan-Engineering» – Tenge 700 million.

Transfer from the state budget to joint-stock companies means that these finances escape the Parliament's scrutiny within the framework of the budget process. Still remains unclear: who are the founders of these joint-stock companies? If it is the Government, then practice proves that there is an annual decrease of dividends for the state shares as a result of budget implementation. If these are the private companies why is their stock capital formed and replenished from the budget?<sup>14</sup> It is impossible to trace how these finances are utilized, as reports of these organizations are not included into budget reporting, and the Counting Committee does not keep under control utilization of these finances.

In Azerbaijan transfers to other levels of state governance are given as a general amount in the draft budget, the number of municipalities receiving transfers is not announced, and the amount of donations to separate municipality is not presented. There is also no information on the amount of subsidies to state corporations during the current budget year.

The budget, mid-year and year-end reports should disclose the budget programme beneficiaries. Both in Kazakhstan and Azerbaijan the draft budget and reports on its implementation do not contain the number of beneficiaries for the programmes,

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<sup>14</sup> Quarterly Predictions. – 2003. – №5 – p. 15.

*In Kazakhstan and Azerbaijan budget documentation does not disclose tax expenditures*

there is no data aiding to reveal the number of citizens covered by these or other measures of the Government. For example, the draft budget in Kazakhstan for 2004 provided Tenge 170.7 billion for retirement allowances; however, the number of recipients was not mentioned.<sup>15</sup>

## **2.4. Tax Expenditures**

IMF recommends including information on the nature and budget significance of governmental tax expenditures into budget documentation. Tax expenditures, as IMF *Manual* explains, «include exemptions from the tax base, allowances deducted from gross income, tax credits deducted from tax liability, tax rate reductions, and tax deferrals (such as accelerated depreciation). Tax expenditures are often identical in their effects to explicit expenditure programmes». The estimated cost of key tax expenditures should be disclosed as supplementary information in the budget, – OECD recommends in *Best Practices*.

In Kazakhstan tax expenditures are not highlighted in the budget documentation. Since 2004 a special regime of corporate income taxation was introduced for petrochemical organizations. From now on, fixed assets imported by leasing provider with a purpose of financial leasing are VAT-free as well as revenues from financial leasing of fixed assets – this is introduced in order to promote leasing development. However, such preferential tax treatment was not pointed out in the draft budget for 2004.

In order to develop processing (manufacturing) sectors it was proposed to introduce an accelerated depreciation and a privileged calculation of corporate income tax since 2005. However, a draft budget does not disclose tax expenditures.

During the budget implementation in 2003-2004 there was a significant problem of VAT refund growth by circulations leviable by zero rate,<sup>16</sup> related to export growth. However, such trend of development was not forecasted during the preparation of draft budgets.

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<sup>15</sup> In 1998 Kazakhstan switched from solidary retirement system to an accumulative one. Retirement allowances are paid at the expense of the republican budget in accordance with the previous solidary system.

<sup>16</sup> Quarterly Predictions. – №3 (07) – 2004. – p. 14.

A draft budget of Azerbaijan also does not disclose the amount of tax expenditures as a result of tax exemption of any subject of economy.

### ***Tax Expenditures Reporting***

*Germany and USA were the first countries to report tax expenditure information, in the late 1960s. Tax expenditure reports are now a legal requirement in at least nine countries of OECD (Australia, Austria, Belgium, France, Germany, Greece, Portugal, Spain and USA). Most of the countries reporting information do so annually; in Australia, Belgium, Finland, France, Greece, Portugal, Spain and Sweden the tax expenditure report is linked explicitly to the budget process. In Greece central government budget must be accompanied by an attached budget of tax expenditures.*

*Source: Manual on Fiscal Transparency. – Washington, District Columbia: International Monetary Fund, Budget Department. – 2001. – p. 28.*

## **2.5. Quasi-Fiscal Activities**

Based on the nature and potential significance of quasi-fiscal activities for budget status, these operations should be taken into consideration when evaluating the state of public finances. However, identification and a quantitative evaluation of quasi-fiscal operations are complicated and arguable problems, – the IMF *Manual* points out.

Quasi-fiscal activities may be conducted by the Central Bank, public financial institutions, and non-financial public enterprises. According to the *Manual*: «In contrast to explicit fiscal activities, quasi-fiscal activities are often introduced by simple administrative decision, are not recorded in budgets and budgets reporting, and typically escape legislative and public scrutiny».

Kazakhstan's draft budget does not provide information on the Government's quasi-fiscal operations. For example, the Development Bank of Kazakhstan (DBK) established in 2001 provides credits to companies with lower than at the market lending rates. The IMF in its evaluation of fiscal transparency in Kazakhstan in 2002<sup>17</sup> mentioned that

***Kazakhstan's draft budget does not provide information on quasi-fiscal activities of the Government***

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<sup>17</sup> IMF. Republic of Kazakhstan: Report on the observance of standards and codes (ROSC). Fiscal Transparency Module. October 8, 2002. – P. 7.

*Information on  
quasi-fiscal  
operations of the  
Government of  
Azerbaijan is  
scarcely represented  
in the draft budget*

Government support<sup>18</sup> allows DBK to use funds in the higher risk projects. It was recommended to apply stricter prudential requirements to lending and to declare all risks and results of DBK operations.

IMF recommendations became even more relevant after the last year's widening of quasi-fiscal operations and their influence on general budget status. This relates to establishment of special financial institutions like the National Innovation Fund, Kazakhstan Investment Fund, Corporation on Export Insurance, etc.

The IMF report mentioned that an establishment of the Fund for Social Insurance has potential for additional quasi-fiscal activity. In 2002 the Fund's establishment in Kazakhstan was delayed. Now, after the Fund began its activity from 1 January 2005, the recommendations made by IMF experts became more urgent: «To meet transparency standards, it should be included as part of budget, and the risks associated with use of fund assets should be clearly disclosed. The long-term costs of social insurance would need to be considered in the context of medium- and long-term budget planning».

The National Bank's (NB) activity on implementation of monetary policy also has significant fiscal effects. For example, sterilization of considerable foreign currency inflows in 2004 has a negative impact on the NB's profitability, and hence on the profits tax to the budget. During discussions on 2005 draft budget it was noted that profits tax from the NB is not expected, on the contrary, losses are anticipated. While sterilization is undertaken for monetary purposes (and hence is not a quasi-fiscal activity), it is important, as IMF *Manual* recommends, that its financial implications are reported in the central bank's annual report.

Information on quasi-fiscal activities of the Government of Azerbaijan is scarcely represented in the draft budget. IMF when evaluating fiscal transparency in Azerbaijan<sup>19</sup> emphasized a wide spread of quasi-fiscal operations linked to state enterprises activity: «...particularly in the energy sector, not only does the state tolerate

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<sup>18</sup> DBK founders are the Government and local executive bodies. During the past years replenishment of DBK stock fund was anticipated for several times from the republican budget.

<sup>19</sup> IMF Report on the observance of standards and codes (ROSC) Azerbaijan Republic. November 13, 2000. — P. 3.

substantial tax arrears, but nonpayment by the state-owned gas and electricity companies for the fuel they receive from SOCAR amounts to 7 % and 19% of GDP, respectively. Furthermore, these companies sell at prices considerably lower than world market prices and they also have extremely poor collection rates (e.g. 26%) from their customers, which amount to an indirect subsidy for heat and power that is borne by state owned enterprises in the energy sector».

In Azerbaijan due to quasi-fiscal operations the indirect subsidies to power industry enterprises reached \$700 million in 2003, however, expenditures and revenues in the draft consolidated budget show only general amount of these subsidies. According to the EBRD's evaluation, fiscal and quasi-fiscal subsidies were further reduced<sup>20</sup> consistent with reforms already introduced in the energy sector in 2004.

## 2.6. Financial and Non-financial Assets

Reports on financial assets should disclose all such assets of the Government at the reporting date as well as those at the previous reporting date. The report should contain a clear statement about an accounting policy, which acts as a basis for assets evaluation. Financial assets – to be reflected in the report – include cash and cash equivalents, other monetary assets, general delivery deposits and short-term highly-liquid investments, easily converted into cash. The draft budget should classify financial assets by main types, including cash, market securities, investments in private companies and credits granted to other loaners.

Budget documentation should disclose information about non-financial assets, including real estate and equipment. «Non-financial assets will be recognized under full accrual based accounting and budgeting. This will require the valuation of such assets and selection of appropriate depreciation schedules. The valuation and depreciation methods should be fully disclosed», – *Best Practices* explained.

Budget documentation in Kazakhstan does not have information on the state financial and non-financial assets and how the Government manages them. The draft budget and budget reports

*Draft budgets in Kazakhstan and Azerbaijan, as well as budget reports do not contain information on financial and non-financial assets of the Governments*

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<sup>20</sup> Transition Report Update. European Bank for Reconstruction and Development May 2005. – P. 28.



do not list state owned companies; there is no information on the size of state share holding, which makes it impossible to evaluate adequate incomes to the budget. For instance, according to the draft budget for 2004, corporate tax, VAT and dividends for the state share holding should be transferred to the republican budget. The Government has only noted that based on mid-term plans of the state owned companies and sale of state shares of JSC «CNPC-Aktobemunaigas» a decrease in income is anticipated by 36.9% compared to 2003. It would be more appropriate to publish a list of companies with state share in them and information on planned dividends.

The information about the state-owned enterprises and data for clarifying their efficiency is also not provided. The draft budget for 2004 only provides information on the size of earnings from the republican state enterprises by corporate tax, VAT and part of net tax to be transferred to the budget as well as a short note saying that a profit share is 24.4% less than in 2003 due to a decrease in general amount of net benefit of republican state enterprises.

The draft budget in Azerbaijan as well as budget reports does not contain information about the Government's financial and non-financial assets.

## **2.7. Contingent Liabilities**

*A common example of such contingent liabilities is governmental guarantees of credits ...*

Contingent liabilities are costs which the government will have to pay if a particular event occurs. All contingent liabilities should be reflected in the budget, mid-year report and year-end report. A common example of such contingent liabilities is government-guaranteed loan, state insurance programmes, and legal requirements to the government. «Where the government has set aside reserves, against a specific contingency, this should be noted in the statement of contingent liabilities», – IMF *Manual* recommends.

The Government of Kazakhstan presents some data on contingent liabilities in budget draft and budget reports, however this information is not comprehensive. For instance, the draft budget for 2004 sets a limit size for state guarantees, it also allocates assets for replenishment and servicing of the Government-guaranteed loans. In the same document the government drops demands to legal entities on credits and assets drawn for implementation of obligations by state guarantees



(liquidated as of 1 January 2004). However, a list of organizations and the debts repaid by the Government (means by all tax payers) are not provided.

The draft budget for 2004 also reserves expenditures (among expenditures of the Ministry of Finance of the RK) for liquidation of natural and man-made disasters and other unforeseen expenditures. Expenditures of the Ministry of Justice include a reserve for cancellation of the government commitments, central state bodies and local subdivisions by the court decision (at the level of 2003).

A note about utilization of reserve assets is attached to the Government's report on 2003 budget implementation, however, historic information about failure to fulfill obligations by each category is not provided.

Budget documents in Azerbaijan do not contain contingent liabilities. In 2005 the Reserve Fund under the President of Azerbaijan Republic was established in accordance with the amendments to the Law *On Budget System*. The Fund's assets should not exceed 2% of total expenditures of the state budget and should be utilized during the budget year.

*The Government of Kazakhstan presents some data on contingent liabilities in its draft budget and budget reporting documents, however, this information is not comprehensive*

*Budget documents in Azerbaijan do not contain contingent liabilities*

### 3. Control and Accountability

#### 3.1. Audit

The major requirement for fiscal transparency is a timely control of financial reliability of the state bodies' accounts by the supreme audit body, which should be independent from the executive. Audit reports should be presented to the Parliament and be open to public.

An audit of the state governance bodies is aimed at monitoring compliance with fixed norms. The auditor presents his (her) conclusions on audit results in written form.

For reasons of national security certain special provisions can be applied, which limit publication of audit reports for military or security expenses. However, in these cases, as *IMF Manual* states, it is important that a civil agency audits all military expenditures and the audit results are submitted to the Parliament.

After an audit is completed the agency which was audited should present a written statement on measures taken to respond to auditors' observations.

*In Kazakhstan the Counting Committee provides external control over republican budget implementation*

*After submission of the report to the Parliament it is made available on the web-site of the Counting Committee ...*

*...This year for the first time it was published in the newspaper*

*The Counting Chamber – is a body, which conducts independent audit of the state budget in Azerbaijan, it was established by the Parliament in 2001*

The audit bodies should not be under control of the executive branch. *Lima declaration of Guidelines on Auditing Precepts* appeals to audit independence.<sup>21</sup>

In Kazakhstan the Counting Committee provides external control over the implementation of the republican budget. It has 9 members. The President appoints the chair and two members for a 5-year term, Majilis and Senate of the Parliament assign three members each for a 5-year term. The Counting Committee Secretariat employs 30 staff. A small staff does not permit a timely and comprehensive audit of all the ministries and agencies.

The Counting Committee has a right to involve specialists from the state bodies, audit organizations and experts to ensure quality control and independent expertise. This rule was introduced by the *Rules of organization and conduct of external control for republican budget implementation and evaluation of programme effectiveness during external control of budget implementation*. Taking on this opportunity makes work easier for the Counting Committee.

In accordance with the Budget Code the Government submits to the Parliament and the Counting Committee an annual report on the implementation of the republican budget for the past year and supplementary documentations not later than 1 May of the current year. The Counting Committee submits to the Parliament a report on implementation of the republican budget before 1 June. Its content is a final conclusion of the Government's report on the implementation of the republican budget. After submission of the report to the Parliament it is made available on the web-site of the Counting Committee: [www.esep.kz](http://www.esep.kz), where all reports on budget implementation for last years are posted. In 2005 for the first time it was published in the newspaper.<sup>22</sup>

The report of the Counting Committee analyses macroeconomic conditions of the republican budget implementation, compares probable and actual macroeconomic indicators. The report provides analysis on all revenue sources and expenditures by functional groups. A comparison of reports for 2002, 2003 and

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<sup>21</sup> <http://www.intosai.org/>.

<sup>22</sup> Report of the Counting Committee on the implementation of the republican budget// *Kazakhstanskaya Pravda*. – 2005. – 9 July. – №182-183.

2004 reveals some progress in highlighting problematic issues. Since 2003 the report contains a chapter on the Government's measures to respond to the recommendations made by the Counting Committee on improvement of budget procedures.

It should be noted that the Government's report on budget implementation submitted to the Parliament provides no information on measures to fulfill the auditors' recommendations.

The Counting Chamber conducts independent audit of the state budget in Azerbaijan. The Parliament assigns members of the Chamber for 7 years. Every year the Counting Chamber makes a statement in the Parliament with the conclusions on the state budget report. There is a very short time between the submission of the report on budget implementation to the Parliament and its approval. This time is insufficient for the Counting Chamber to conduct a full-fledged audit. The report on budget implementation and audit reports of the Counting Chamber are not open to the public.

The conclusions on the state budget (in Azeri language) are posted on the web-site of the Counting Chamber. The information provided includes an analysis of revenues and expenditures of the Government for target utilization, a comparison of actual revenues and expenditures with probable indicators. However, conclusions of the Counting Chamber are posted with a year delay.

The Counting Chamber has a small Secretariat and it is not fully staffed – out of 7 auditors only 4 are assigned, which limits its opportunities for a timely and comprehensive audit of all ministries and agencies, and organizations funded from the republican budget. That is the reason why after two and even more years after the end of the financial year only several ministries and agencies have been audited. The audit results are made available to the public in a form of a short summary provided by the Counting Committee.

In Kazakhstan and Azerbaijan supreme audit bodies do not audit oil funds. In Kazakhstan in accordance with the Budget Code the Counting Committee does not have such authority. In Azerbaijan according to the Law the Counting Chamber has a right to audit extra-budget funds; however, this right has not been exercised yet. Up until now the National Fund of the RK, and the Oil Fund of the AR were audited by audit companies-members of the «Big Five».

*The report on budget implementation and audit reports of the Counting Chamber are not open to the public*

*In Kazakhstan and Azerbaijan supreme audit bodies do not audit oil funds*

*Neither the  
Counting  
Committee of  
Kazakhstan nor the  
Counting Chamber  
of Azerbaijan audit  
state owned  
companies*

The Counting Committee of Kazakhstan and the Counting Chamber of Azerbaijan do not audit state owned companies. As was mentioned above, significant budget resources in Kazakhstan are withdrawn for establishment of different joint-stock companies. The Counting Committee does not provide audit of finances allocated from the budget due to limited authority. The Government does not submit reports on utilization of these finances to the Parliament.

The latest amendments to the budget legislation of Azerbaijan widened the functions of the Counting Chamber: they have a right to audit extra-budget expenditures of institutions supported from the state budget. However, taking into consideration the above-mentioned constraints it is quite difficult to predict when it will be exercised.

In response to the recommendations made by the Counting Chamber of Azerbaijan to any executive bodies the latter do not inform the Parliament on the measures they undertake to fulfill the auditors' recommendations. The Counting Chamber and the Parliament do not issue reports reflecting reaction of the executive to the recommendations of the auditors.

### **3.2. Public and Parliamentary Scrutiny**

The Parliament should have an opportunity and resources to effectively examine any fiscal report that it deems necessary.

The Parliament in Kazakhstan approves the republican budget, amendments and additions to the republican budget, approves reports of the Government and the Counting Committee.

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The Parliament is partially involved in budget drafting as representatives of both chambers of the Parliament are members of the Republican Budget Commission, which drafts the budget. Clarity of roles and responsibilities are the first requirement in the IMF *Code*. «The responsibilities of the executive branch, the legislative branch, and the judiciary, should be well defined», – the *Code* recommends. In our opinion, responsibilities of executive and the legislative branches in the budget policy should be divided. A preparation of a draft budget is the task of the Government, and participation of the Parliament members in this process is not required.

After receiving a draft budget the Parliament has three months to discuss and adopt it. The Chambers of the Parliament have

a right to listen to the statements of the heads of the republican budget programmes during plenary and joint sessions on the draft budget. The draft budget is discussed at joint meetings of the Parliament chambers in no less than two readings. A discussion includes statements of the Minister of Economy and Budget Planning, the Minister of Finance, the National Bank's Chairman.

The Parliament's budget public hearings of separate ministries and agencies with a participation of public representatives are not in practice.

The executive bodies may present more detailed information on the draft budget, if members of the Parliament request it. The Parliament has a right to make amendments to the budget presented by executive bodies with certain limitations. Voting for or against the budget in the Parliament should not be seen as a «vote of confidence» to the Government.

The Parliament of Kazakhstan has limited opportunities to control government finance. An annual budget review during 2002-2005 reveals that the Parliament considers the draft republican budget to a degree considered necessary by the government. The National Fund, the resources of which are comparable with the republican budget, is out of the Parliament's oversight. The Counting Committee is not accountable to the Parliament but to the President.

*The Parliament of Kazakhstan has limited opportunities to control government finance*

In Azerbaijan the Parliament is not involved into the process of budget drafting. In autumn when the draft budget is submitted to the Parliament it is introduced to the representatives of the parliamentary commission on economic policy. Usually the commission representatives do not have enough time for detailed consideration of the draft and for working out recommendations as the budget should be introduced for general discussion by all the deputies and approval by the year end.

*The Parliament of Azerbaijan has limited rights to introduce amendments to the draft state budget*

The Parliament of Azerbaijan has limited rights to introduce amendments to the draft state budget. In accordance with the Law, Milli Medjlis has a right to present recommendations to the Cabinet of Ministries on the draft budget. The latter has rights to adopt or deny them.

The Cabinet of Ministries of Azerbaijan carries out active consultations with the legislators during discussions in the Parliament. It is obligatory that the Parliament approves the

*In Kazakhstan and Azerbaijan public hearings on budgets of separate ministries and agencies are not conducted*

*A draft budget and reports on its execution should be open to public*

*The Ministry of Finance should actively promote an understanding of the budget by citizens and non-governmental organizations*

amendments to the revenues and expenditures of the state budget during the year.

In order to distribute expenditures between the administrative units a sanction from the Parliament is not required, the Ministry of Finance does it independently. Among exceptions are protected budget expenditures, mentioned in the Law. The Ministry of Finance has no right to amend their amount within the framework of the approved budget.

Apart from the draft state budget, the Parliament of Azerbaijan considers all reports prepared by the Counting Chamber. They may include conclusions related to the draft budget and report of the Government on budget implementation, reports on the audit outcomes of separate ministries, agencies etc. The Parliament does not hold public hearings on the draft state budget, budgets of the separate ministries and agencies.

### ***Civil society participation in budget process***

A draft budget and reports on its execution should be open to public. The Ministry of Finance should actively promote an understanding of the budget by citizens and non-governmental organizations, – *Best Practices* recommends.

In the USA and Western Europe countries the executive bodies publish «citizen's budget», which helps non-specialists to understand the key points of a draft budget. It is oriented at as wide group of population as possible, which exceeds a group of regular consumers of budget information from capital cities and financial centers.

Moreover, the governments of these countries provide public with non-technical definitions of terms used in the budget and other budget-related documents, which makes budget terminology more comprehensible to non-specialists.

In Kazakhstan legislation does not prevent participation of civil society in the budget process; however, in fact, these opportunities are limited. A draft budget is not published, and representatives of the executive branch do not hold any consultations with public when identifying budget priorities.

A brief explanation of the budget and its prospects is attached to the draft republican budget of Kazakhstan submitted to the Parliament but it is not published and is not open to public. The list of major budget terms is not attached to the draft budget; however, such glossary is available in the Budget Code.



Until recently non-governmental organizations (NGO) were not interested in budget work. In February 2003 the Public Policy Research Center in collaboration with the International Budget Project with support of Eurasia Foundation conducted a first training for NGOs from all regions of Kazakhstan on citizen participation in the budget process. Since then, a number of NGOs provide monitoring of budget implementation in different areas. There are samples of budget analysis aimed at social support of disabled people, education, healthcare, programme «drinking water», etc.

In Azerbaijan an explanation to the draft budget is prepared but it is very short and does not disclose many issues of concern for the public. As for the explanations of technical budget terms, the Law *On Budget System* has a list of basic terms definitions even though it lacks some required budget terminology.

The Governments of Kazakhstan and Azerbaijan do not publish «citizen's budget», they do not hold consultations with public when developing budget priorities.

*The Governments of Kazakhstan and Azerbaijan do not publish «citizen's budget», they do not hold consultations with public when developing budget priorities*

## Conclusions and Recommendations

An analysis of the draft budgets in Kazakhstan and Azerbaijan and their comparison with the requirements of *Code* and *Best Practices* revealed the following.

The draft budgets have the same list of indicators necessary for such documents: income structure is classified by functional, administrative and economic categories. The structure of expenditures in Kazakhstan is classified only by administrative and functional categories but economic classification is not provided. In the draft budgets of Azerbaijan expenditures are presented by all three types of classification.

The content of the draft budget in both countries does not comply with the requirement of comprehensive information, one of the major principles of budget system legally identified. Draft budgets do not contain information on quasi-fiscal activities, financial and non-financial assets of the Government, tax expenditures, on the range of budget programmes beneficiaries. Contingent liabilities in Kazakhstan are partially highlighted; in Azerbaijan they are not included in budget documentation.

A limited amount of information is provided on state debt, at the same time the schedule and terms of debt repayment are

*The content of the draft budget in both countries does not comply with the requirement of comprehensive information, one of the major principles of budget system legally identified*

not given, neither are currency new loans to be performed and repaid. At present time, in Kazakhstan a draft budget only contains information on debt limit by the end of the year, payment of interest (total amount). In Azerbaijan a draft budget contains a debt amount as per beginning of July of the current year, a forecast of new loans size and payment for the next year.

A positive development in budget preparation in Azerbaijan is a legally fixed requirement to publish a draft budget in mass media after its submission to the Parliament.

In Kazakhstan a lack of such experience leads to public gaining incomplete information out of statements of some members of the Government and the Parliament, publications in mass media. This does not stimulate debates on key budget indicators or comprehensive public awareness on this issue.

Along with the draft budget the Government of Azerbaijan submits to the Parliament reports on budget implementation for the two previous financial years. Information is compiled in such a way that it helps to make comparisons.

In Kazakhstan and Azerbaijan the governments do not analyze budget sensitivity in the draft budget: its consolidated influence on economy and an interrelation with other aspects of macroeconomic policy and risk analysis.

The process of budget implementation is the most open stage of the overall budget process in Kazakhstan. Monthly results of budget implementation are published in *Statistical Bulletin* and on the web-site of the Ministry of Finance of the RK. Data presentation format, methodology, definitions and budget classification mainly correspond to recommendations provided by the *IMF Manual on Government Finance Statistics* and *OECD Best Practices*.

In Azerbaijan the Ministry of Finance prepares current and annual reporting documentation on budget implementation for administrative use only and this data is not published.

We have developed recommendations for Kazakhstan based on the outcomes of the study. The following steps will promote transparency of budget process and practical fulfillment of principle of comprehensive and transparent budget system declared in the Budget Code (article 3).

***To develop and present an annual budget address.*** It will become a basis for the next year budget, which shall promote



stability of the budget process and predictability of major budget indicators.

***To make amendments and additions to the Budget Code in order to include information, this will promote comprehensive budget evaluation, into draft budget and accompanying documentation.***

- To provide analysis of different macroeconomic indicators, influencing budget and risks forecast.
- To provide expenditures by economic classification.
- To highlight expenditures at the programme level, indicate quantitative evaluation of programme beneficiaries.
- To give a realistic assessment of the state debt. Information about debts should contain data on debt composition, interest, and repayment schedule.
- To disclose comprehensive information on contingent liabilities, on future obligations, quasi-fiscal operations of the Government, its financial and non-financial assets.
- To present information on tax expenditures. This implies that a draft budget should reflect budget losses related to endowment of tax privileges to different enterprises and sectors of economy.
- To publish a list of companies with state shares and expected dividends from each of them.

***The Government should submit to the Parliament reports on budget implementation for the two previous years along with a draft budget.***

This allows deputies of the Parliament to have a comparative analysis of budgets. At the same time it is important to have an adequate format of presented information, as state budget expenditures are not classified in the draft budget by economic category but only by functional and administrative categories, and reporting is published by economic, administrative and functional classification.

***To publish a draft republican budget.***

A publication of a draft budget by the Government after its submission to the Parliament in official publications would

promote a public debate on its key parameters. The Members of Maslikhats in the regions of Kazakhstan, research institutes, political parties, NGOs would have an opportunity to introduce to the Parliament their comments and proposals for the major financial plan of the country for the next year.

***The Government should not introduce to the Parliament the «Mid-term Fiscal Policy» along with a draft budget, but, at least, three months before its submission (accordingly, before 1 June).***

***To make amendments to monthly and year-end budget reports.***

This relates to highlighting in reports all indicators to be included into a draft budget.

- To disclose quantitative evaluation of budget programme beneficiaries.
- To give a real estimate of state debt highlighting debt components, interests, repayment schedules.
- To provide comprehensive information on fulfillment of contingent liabilities, quasi-fiscal activities, current financial and non-financial assets of the Government.
- To provide information on tax expenditures.
- To publish a list of companies with state share and dividend earnings from each of them.
- To provide comprehensive information on utilization of financial resources allocated from the budget to all organizations (for replenishment of stock fund or with other purposes), regardless of the property type.

***To prepare and publish mid-year report on budget implementation.***

At present time out of all general reporting types a preparation of a ***mid-year report*** is not practiced. The half-year results published at present time in the *Statistical Bulletin* and on the web-site of the Ministry of Finance do not differ from the same monthly reports. A special mid-year report should contain an analysis of economic assumptions used when drafting the budget, their influence on budget implementation process, an evaluation of changes of macroeconomic conditions relevant

to budget implementation and of influence of any other decisions of the Government on budget implementation.

***To increase capacity of the Counting Committee.*** It is necessary to make it independent by providing it with personnel and technical resources necessary for a full audit of public finance. The Counting Committee should implement audit of the national companies, new development institutions, companies, in which the Government holds state shares, joint-stock companies, which receive funds from the budget. The audit outcomes should be published and made available to public.

***To increase the role of the Parliament in public finance scrutiny.*** The Parliament Members should have a precise analysis of draft budget submitted for their consideration, attention should be paid to how comprehensive is the information presented. Budget preparation and its implementation is the prerogative of the Government. However, the Parliament plays an active role in budget policy making by being involved in discussions and its approval, as well as in reporting on its implementation. The MPs may increase capacity of the Parliament and civil society to improve budget transparency through collaboration with public organizations and involvement of experts for draft budgets, budget reporting evaluation.

A clear understanding of which issues should be highlighted by the Government in the draft budget and budget reporting in accordance with the *Code* and *Best Practices* should stimulate MPs to make proposals on relevant amendments to the Budget Code.

This will result in greater responsibility of the Government when submitting the draft budget and reports to the Parliament. An active participation of deputies in the budget process will improve transparency of budget policy.

***Civil society should regular monitor the republican and local budgets at all stages of the budget process.*** Only regular involvement of civil society – NGOs, mass media, and political parties – at each stage of the budget process will promote all levels of authority to pay greater attention to disclosure of budget information.

An aspiration of civil society to start a dialogue with the executive power, to get acquainted with the budget documents, exchange opinions on key budget issues, discuss with the deputies of the Parliament and Maslikhat budget priorities – will influence the effectiveness of budget expenditures.

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## Annex

*Table 1. Macroeconomic Indicators in 2004*

	Kazakhstan	Azerbaijan
GDP, Billion US Dollar	40.743	8.523
GDP per capita, US Dollar	2.710	1.041
GDP growth, annual %	9.2	10.2
General budget balance of the Government	2.2	0.8
General state expenditures	23.9	26.3
General state debt	12.1	21.3
Exchange rate, average annual, to 1 Dollar	Tenge 136.0	Manat 4913.5
Population, million	15.0	8.3
GNP (Atlas method, billion US Dollar)*	33.780	7.828
GNP per capita (Atlas method, billion US Dollar)*	2260	950

Source: Transition report update. European Bank for Reconstruction and Development May 2005, \* – World Development Indicators database, World Bank, 15 July 2005.

*Table 2. List of web-sites*

<b>Kazakhstan</b>	
www.parliament.kz	Web-site of the Parliament of the Republic of Kazakhstan (RK)
www.nationalbank.kz	Web-site of the of the National Bank of the RK
www.government.kz	Web-site of the Government of the RK
www.minfin.kz	Web-site of the Ministry of Finance of the RK
www.minplan.kz	Web-site of the Ministry of Economy and Budget Planning of the RK
www.esep.kz	Web-site of the Counting Committee on Control of Budget Implementation of the RK
www.nationalfund.kz	Web-site of the National Fund of the RK
www.stat.kz	Web-site of the Agency on Statistics of the RK
www.nalog.kz	Web-site of the Tax Committee of the Ministry of Finance of the RK
<b>Azerbaijan</b>	
www.meclis.gov.az	Web-site of the Parliament (Milli Medjlilis) of Azerbaijan Republic (AR)
www.economy.gov.az	Web-site of the Ministry of Economic Development of AR
www.ach.gov.az	Web-site of the Counting Chamber of AR
www.nba.az	Web-site of the National Bank of AR
www.oilfund.az	Web-site of the Oil Foundation of AR
www.azstat.org	Web-site of the Agency on Statistics of AR
www.taxes.gov.az	Web-site of the Ministry of Taxes of AR
www.socar_cc.com	Web-site of the State Oil Company of AR

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